

**DEPARTMENT OF STATE REVENUE
SUPPLEMENTAL LETTER OF FINDINGS: 98-0491
STATE GROSS RETAIL AND USE TAXES
For the Years 1994, 1995, and 1996**

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ISSUES

- I. Sales / Use Tax Assessment on Manufacturer's Purchase of Labels:** Applicability of the Gross Retail Tax to Purchases of UPC / Bar Code Labels Affixed to Taxpayer's Non-returnable Containers.

Authority: IC 6-2.5-5-6; 45 IAC 2.2-5-14.

Taxpayer protests the imposition of sales tax on the purchase of certain labels which are affixed to the taxpayer's non-returnable containers. The assessment was made when audit determined that, because the labels were not incorporated as a part of the tangible personal property which taxpayer produces for resale, the initial purchase of the labels was subject to sales tax. Taxpayer argues that the purchase of the labels is exempt from sales tax because the labels are incorporated into the taxpayer's property made available for resale.

- II. Sales and Use Tax Assessment on the Purchase of Printing Equipment.**

Authority: IC 6-2.5-5-3(b); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983).

Taxpayer argues that the initial purchase of label printers was exempt from imposition of sales tax. Taxpayer maintains that the label printers are used in the direct production of the taxpayer's final product and, as such, the purchase of the label printers is exempt. The audit found to the contrary – determining that the printers did not qualify for the manufacturing exemption.

STATEMENT OF FACTS

Taxpayer manufactures automobile safety parts such as lights, reflectors, and mirrors. These parts are manufactured in Indiana and then shipped to various distributors. Taxpayer requested a rehearing on certain of the issues addressed within the original Letter of Findings. The Department granted taxpayer's request and, although the taxpayer declined the opportunity to

address the issues at an administrative hearing, this Supplemental Letter of Findings was based upon the taxpayer's written submission.

DISCUSSION

I. Sales / Use Tax Assessment on Manufacturer's Purchase of Labels.

Taxpayer reasserts its original position that the purchase of certain labels is exempt from imposition of the state's gross retail (sales) tax. The labels at issue display UPC / Bar Code information and are fastened to the outside of the taxpayer's non-returnable containers. Inside these closed containers are multiple packages of either the taxpayer's finished goods or component parts destined for assembly elsewhere. The coded labels provide information which identifies the contents of the package and the quantity of items contained within the package. The labels serve to facilitate the movement and tracking of taxpayer's inventory within taxpayer's own warehouse facility and – according to taxpayer – serve the same purpose for the taxpayer's customers. Taxpayer asserts that the affixing of the labels is a mandatory pre-requisite to its distributor's acceptance of the packaged products. According to taxpayer, the distributors will not accept taxpayer's packaged goods if the package does not display one of the labels here at issue.

The audit determined that the labels were subject to sales tax because the labels were not "incorporated" into the taxpayer's manufactured products.

Taxpayer argues that IC 6-2.5-5-6 provides that statutory authority for its assertion that the labels are exempt from sales tax. The statute states in relevant part that, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business." In effect, taxpayer argues that the labels are "incorporat[ed] as a material part" of its automotive parts.

Departmental regulation 45 IAC 2.2-5-14 provides specific guidance in applying the general statutory rule. The regulation states that in order to find that material is incorporated into the property produced for resale, "[t]he material must be physically incorporated into and become a component of the finished product . . . [t]he material must constitute a material or integral part of the finished product . . . [t]he finished tangible personal property must be produced for sale by the purchaser." 45 IAC 2.2-5-14(d).

There can be little dispute that taxpayer's labels are an essential component within taxpayer's marketing and distribution process. Notwithstanding, the purchase of taxpayer's labels is not entitled to the manufacturing exemption afforded under IC 6-2.5-5-6 because the labels do not become a "material part" of the taxpayer's various automotive products. The labels do not "constitute a material or integral part of the finished product," (45 IAC 2.2-5-14(d)(2)) because the labels are not essential to the taxpayer's finished product and because the labels do not affect the performance or utility of that finished product. The labels are merely the ancillary means by which taxpayer's finished product finds its way to the ultimate consumer.

FINDING

Taxpayer's protest is respectfully denied.

II. Sales and Use Tax Assessment on the Purchase of Printing Equipment

Taxpayer argues that the initial purchase of label printers is exempt from imposition of the sales tax. Taxpayer predicates this argument upon the provisions of IC 6-2.5-5-3(b) which states that "[t]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." The court has determined that exempt equipment must constitute "an integral part of manufacturing and operate[] directly on the product during production." Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 525 (Ind. 1983). In addition, the exempt equipment must have an "immediate link with the product being produced." Id.

Taxpayer's products consist of various automotive parts. Taxpayer's label printers act upon and produce UPC/ Bar Code labels. Accordingly, taxpayer's initial purchase of the label printers does not qualify for a sales tax exemption under IC 6-2.5-5-3(b) because the label printers are not an integral part of the taxpayer's production process, and because the printers do not operate on the taxpayer's automotive products. Although the label printers may serve as indispensable part of taxpayer's overall manufacturing and distribution process, the printers stand outside of, and are removed from, taxpayer's actual production of automotive parts.

FINDING

Taxpayer's protest is respectfully denied.